

REPORT OF EXAMINATION
FIRST NATIONAL INSURANCE COMPANY
OF AMERICA

Seattle, Washington

December 31, 2000

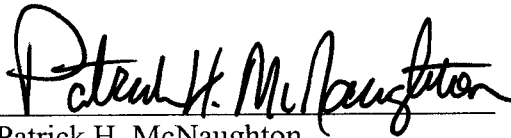


States Participating:

Washington
Delaware
Nevada

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that I have reviewed the attached Report of Examination of the financial condition and affairs of FIRST NATIONAL INSURANCE COMPANY OF AMERICA of Seattle, Washington, as of December 31, 2000.

A handwritten signature in black ink, reading "Patrick H. McNaughton". The signature is written in a cursive style with a large initial "P".

Patrick H. McNaughton
Chief Examiner

9-11-03

Date

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SALUTATION

Seattle, Washington
August 27, 2003

The Honorable Alfred W. Gross
Commissioner, Commonwealth of Virginia
Chair, NAIC Financial Condition (EX)
Committee
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

The Honorable John Morrison
Commissioner, Montana Department of
Insurance
NAIC Secretary, Western Zone
840 Helena Avenue
Helena, MT 59601

The Honorable Susan F. Cogswell
Commissioner, Connecticut Dept. of
Insurance
NAIC Secretary, Northeastern Zone
PO Box 816
Hartford, CT 06142-0816

Honorable Mike Kreidler
Commissioner, Washington State
Office of Insurance Commissioner
5000 Capitol Boulevard
PO Box 40255
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with the statutory requirements of Chapter 48.03 of the Revised Code of Washington (RCW), an Association Examination was made of the corporate affairs and financial records of the

FIRST NATIONAL INSURANCE COMPANY OF AMERICA of Seattle, Washington

hereinafter referred to as the "Company", at its home office located at SAFECO Plaza, 4333 Brooklyn Avenue Northeast, Seattle, Washington 98185.

The Company wrote personal, commercial and surety lines of insurance through independent agents. Included in the lines of insurance written are automobile, homeowners, fire, commercial multiple peril, workers' compensation, miscellaneous casualty, surety and fidelity. The Company was licensed in all states, except Maine and New Hampshire, and was licensed in the

District of Columbia and the Dominion of Canada. A listing of the Company's affiliates and the Company's relationship as a member of an insurance company holding system is included in this Report of Examination under the caption "AFFILIATED COMPANIES". The Company was under the control of and managed by a Board of Directors. Officers were appointed by the Board of Directors to operate the Company. The Company had entered into an intercompany reinsurance agreement whereby SAFECO Insurance Company of America, an affiliate, assumed 100% of the direct business written by the Company and assumed 100% of the direct business written and assumed by 12 other affiliated companies. Direct business written by SAFECO Insurance Company of America and the business assumed from the 13 affiliated companies was pooled. SAFECO Insurance Company of America arranged for excess and catastrophe reinsurance on the pooled business with nonaffiliated companies, as needed. SAFECO Insurance Company of America retained 33% of the pooled business and retroceded 67% of the business to seven affiliates. As of December 31, 2000, the Company had a 2% participation in the pool.

The last examination was as of December 31, 1995. The following Report of Examination is respectfully submitted showing the condition of the Company as of December 31, 2000.

SCOPE OF EXAMINATION

Per RCW 48.03.010, the examination covered the five-year period from January 1, 1996 through December 31, 2000. The Company was last examined as of December 31, 1995 by examiners representing Washington, Delaware and Ohio (General Interrogatory No 22 (d) of the Company's 2000 Annual Statement incorrectly reported that the last financial examination was made by the Washington, Louisiana, Vermont, Illinois and North Dakota Insurance Departments). On April 19, 2001, an Association Examination was called to begin on June 4, 2001. Insurance examiners from the states of Washington, Delaware and Nevada conducted the current examination concurrently with the Association Examination of five other companies domiciled in Washington – SAFECO Insurance Company of America, General Insurance Company of America, SAFECO Surplus Lines Insurance Company, SAFECO Life Insurance Company and SAFECO National Life Insurance Company. The Southeastern and Midwestern Zones of the National Association of Insurance Commissioners (NAIC) were invited to participate in the examination but elected to decline.

A December 31, 2000 examination of SAFECO National Insurance Company was conducted concurrently by the Missouri Insurance Department. December 31, 2000 examinations of SAFECO Insurance Company of Illinois and its subsidiary, Insurance Company of Illinois, were also conducted concurrently by the Illinois Insurance Department.

The examination of the Company was conducted in accordance with the laws of the state of Washington contained in Title 48 RCW and regulations contained in Title 284 Washington

Administrative Code (WAC) and the examination procedures prescribed by the NAIC Financial Condition Examiner's Handbook.

Corporate records and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. Comments on any adverse findings that are applicable to the current examination are included in the "INSTRUCTIONS", "COMMENTS AND RECOMMENDATIONS" and "ACCOUNTS AND RECORDS" sections of this report.

INSTRUCTIONS

The examination disclosed the following issues that require Company action:

1. Unreconciled Bank Balance

The bank confirmation received from the Royal Trust Company, Toronto, Canada, differed from the Company's 2000 Annual Statement balance by an irreconcilable amount of \$116,702. The \$116,702 difference, subsequently written off in 2002, has been [nonadmitted](#) on the financial statements of this report. Our examination concluded the controls in place were inadequate for timely and accurate reconciliations.

The results of the examination disclosed additional internal control deficiencies, two of which are detailed in the "ACCOUNTS AND RECORDS" section of this report. Pursuant to RCW 48.05.280, the Company is required to ensure that all accounting controls be reviewed, and deficiencies identified and corrected.

The Company is instructed to comply with RCW 48.05.250(1) which requires the Company to file a true statement of its financial condition, transactions and affairs and RCW 48.05.280 which requires every insurer to keep full and adequate accounts and records of its assets, obligations, transactions, and affairs.

2. Loss and Loss Adjustment Expense Reserves

The reserves carried by the combined property and casualty companies of the SAFECO Group for these liabilities were \$3,482,472,780 and \$786,665,886, respectively, as of December 31, 2000.

The reserves for the combined companies were reviewed by the casualty actuarial staff employed by the Washington [State](#) Office of Insurance Commissioner (OIC). The actuarial staff selected several lines of business, comprising approximately 59% of the companies' gross loss and loss adjustment expense reserves, for detailed review. Company personnel provided loss and loss adjustment expense development data for these lines of business as of June 30, 2002 (in other

words, the data included eighteen months of development subsequent to the examination period). Company personnel also provided additional information by electronic mail and in several face-to-face meetings. The actuarial staff also reviewed actuarial reports and Statement of Actuarial Opinion prepared by the companies' Board of Directors appointed actuary with the companies' consulting actuarial firm, Ernst & Young LLP.

Based on their analysis of data through June 30, 2002, the OIC's actuarial staff concluded that the companies booked reserves, particularly for the workers' compensation and general liability lines of business, were deficient as of December 31, 2000. Since December 31, 2000, the companies have taken significant steps to strengthen their loss and loss adjustment expense reserves for 2000 and prior years. These steps were reflected, in part, in the one year loss development of \$339,274,000 for all lines of business shown on Page 23 of the combined companies' Annual Statement for 2001.

The OIC's actuarial staff made the following examination adjustments to the reserves as of December 31, 2000, on a combined-companies basis:

	<u>Booked Reserve</u>	<u>Examination Adjustment</u>	<u>Restated Reserve</u>
Losses	\$3,482,472,780	\$357,829,000	\$3,840,301,780
Loss adjustment expenses	786,665,886	93,742,000	880,407,886

Under the SAFECO intercompany pooling agreement, the Company's liability was 2% of the total. Therefore, the examination adjustments to the Company's reserves as of December 31, 2000, were:

	<u>Booked Reserve</u>	<u>Examination Adjustment</u>	<u>Restated Reserve</u>
Losses	\$ 69,649,457	\$ 7,156,580	\$ 76,806,037
Loss adjustment expenses	15,733,318	1,874,840	17,608,158

The Company is instructed to make provision for the examination adjustments to its loss and loss adjustment expense reserves which will place the Company in compliance with RCW 48.12.030(2), which provides that the Company estimate its provision to pay its unpaid losses and claims incurred on or prior to the date of the annual statement together with the expense of adjustment or settlement thereof.

3. Prohibited Investments in Foreign Securities

The Company had invested in foreign bonds (other than Canadian bonds) having an admitted value of \$2,993,524 and \$30,100 in admitted accrued interest as of December 31, 2000. As of December 31, 2000, the Company transacted business only in the United States and Canada.

The Company made the investment transactions in foreign securities, excluding Canadian securities, (that is, where the issuing company is incorporated outside the United States) under the belief that the foreign securities were permitted and allowed as miscellaneous assets under RCW 48.13.240. The OIC indicated that investments in foreign securities were limited to those categories described in RCW 48.13.180. The remedies under the code did not provide for the non-admission of the foreign securities.

The Company is instructed to comply with RCW 48.13.290(1) which states, “Any ineligible personal property or securities acquired by an insurer may be required to be disposed of within the time not less than six months specified by order of the commissioner, unless before that time it attains the standard of eligibility. . . .” Under this Examination Order, the Company will be required to dispose of ineligible foreign securities in a time frame as specified under Special Consent Order No. 98. See item No. 1 under “SUBSEQUENT EVENTS” for special consent order No. 98 issued by the OIC on December 20, 2002.

4. Insurer Holding Company Act Violation

SAFECO Asset Management Company (SAM), an affiliate acquired by SAFECO Corporation in 1973, serves as the investment advisor for the Company and its affiliates. Numerous investment transactions were conducted between the Company and SAFECO Asset Management Company during the five year period under review for which no intercompany agreement was in force to define the rights and responsibilities and cost reimbursement methodologies.

These affiliate services performed by SAM are required to be “fair and reasonable” as to terms and charges pursuant to RCW 48.31B.030(1)(a)(i) and (ii). In addition, RCW 48.31B.030(1)(a) requires: “(iii) Expenses incurred and payment received must be allocated to the insurer in conformity with customary insurance accounting practices consistently applied; (iv) The books, accounts, and records of each party to such transactions must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties”.

The Company is instructed pursuant RCW 48.31B.030(1)(b)(iv) to submit for approval to the OIC an intercompany agreement with SAM and all pertinent affiliates which complies with RCW 48.31B.030(1)(a).

5. Errors in Annual Statements

Review of the Company's Annual Statements for the period under examination disclosed numerous errors and/or omissions. RCW 48.05.250(1) states, "Each authorized insurer shall annually, before the first day of March, file with the commissioner a true statement of its financial condition, transactions and affairs as of the thirty-first day of December preceding. The statement forms shall be in general form and context as approved by the National Association of Insurance Commissioners for the kinds of insurance to be reported upon, and as supplemented for additional information required by this code and by the commissioner."

The Company is instructed to review and continue its efforts to substantially strengthen controls to comply with RCW 48.05.250(1) which requires the Company to file a true statement of its financial condition, transactions and affairs. The results of the examination disclosed the following errors in the Company's Annual Statements:

- a) Schedule D of the Company's 1999 Annual Statement listed the purchaser of the Lower Colorado River bonds as "None". Schedule D of the Company's 1996 and 1997 Annual Statements listed the purchaser of Bay Street Gas common shares as "None". The Company indicated that the securities were tendered and the word "None" was an incorrect response.
- b) The accrued interest for cash on hand and on deposit reported in the Underwriting and Investment Exhibit – Part 1 – Interest, Dividends and Real Estate Income of the Company's 2000 Annual Statement did not agree with the accrued interest on cash deposits reported in Schedule E of the 2000 Annual Statement.
- c) The accrued interest for short-term investments reported in the Underwriting and Investment Exhibit – Part 1 – Interest, Dividends and Real Estate Income of the Company's 2000 Annual Statement did not agree with the accrued interest on short-term investments reported in Schedule DA of the 2000 Annual Statement.
- d) The Company's 2000 Annual Statement reported a \$2,645,411 liability for "Payable on Securities"; reported Canada Treasury Bills having a cost of \$2,645,411 in Schedule DA, Part 1; and reported a \$2,844,040 cash balance for the Royal Trust Company, Toronto, Canada, in Schedule E, Part 1. The Company had made the \$2,645,411 payment for the security prior to December 31, 2000. The Company's 2000 Annual Statement should not have reported the \$2,645,411 as a liability under "Payable on Securities" and should have reported a \$196,629 cash deposit with the Royal Trust Company instead of the \$2,844,040. Assets were overstated by \$2,645,411 and liabilities were overstated by a like amount in the Annual Statement.
- e) The Company did not list a number of insurance agencies in Schedule Y, Part 1, which conducted the business of insurance as listed under AFFILIATED COMPANIES. The

Company failed to include in its organizational chart SAFECO UK Limited and numerous insurance agencies which were owned either directly by SAFECO Corporation or by an affiliate. The NAIC Annual Statement Instructions indicate for Schedule Y, Part 1, that a chart or listing presenting the identities of and interrelationships between the parent, all affiliated insurers and other affiliates should be attached to the Annual Statement. RCW 48.01.050 defined an insurer as every person engaged in the business of making contracts of insurance. See comments under "AFFILIATED COMPANIES" of this Report of Examination.

6. Bonds – Amortization

The Company was requested to provide bond amortization schedules for selected securities. The individual amortization schedules provided by the Company did not agree with the amortization reported in Schedule D of the Company's 2000 Annual Statement. The Company explained that it used a tool in PAM (Portfolio Accounting Management System) to prepare the schedules of bond amortization and that the amortization schedules provided were a very simplified way of determining amortization and were not expected to tie to Schedule D which uses more complicated models, algorithms, etc. The Company did not provide individual bond amortization schedules that would tie to the amortization reported in Schedule D.

For example, Schedule D, Part 1 of the Company's 2000 Annual Statement reported:

"During 1999, the Company acquired bonds issued by Austin Texas Water, Sewer and Electric Bonds (CUSIP 052478-BT-0) having a par value of \$310,000 at a cost of \$309,892. The bonds, acquired by the Company in 1999 at a discount, were reported as having a book and admitted value of \$310,032 as of December 31, 2000. The bonds acquired at a discount had a December 31, 2000 admitted value in excess of their par value".

The Company is instructed to correct and maintain amortization schedules on individual investments that will tie to the amortization reported in Schedule D and is instructed to comply with RCW 48.12.170(1)(b) which provides that bonds or evidences of debt having a fixed term and rate purchased above or below par shall be valued on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner.

7. Preferred Stock Not Reported in Annual Statement

The December 31, 2000 bank confirmation received from the Company's custodial bank reported 10,500 shares of preferred stock of Financial Corporation of America (CUSIP 317421-30-3) having a cost of \$1 and no market value. This preferred stock was not reported on Schedule D, Part 2, Section 1 of the Company's 2000 Annual Statement. The Company responded that it had held this asset since 1994 and that it had given the asset a zero value and transferred it to a non-reporting portfolio. The Company indicated that it would transfer the stock to the correct

portfolio and eliminate the non-reporting portfolio; however, a review of the 2001 Annual Statement did not indicate that the stock had been transferred.

The Company is instructed to comply with RCW 48.05.250(1) which requires the Company to file a true statement of its financial condition, transactions and affairs and RCW 48.05.280 that requires every insurer to keep full and adequate accounts and records of its assets, obligations, transactions, and affairs.

8. Agents' Balances or Uncollected Premiums

The Company, through the intercompany pooling agreement, had two receivables in connection with its participation in the Florida Windstorm Underwriting Association (the Association) and with the Company's business with the Association as derived from the assumption of the American States' insurance business in 1997. The Association was prohibited by its state charter from distributing any excess amounts not needed by the Association. The Company's portion of the receivable from the Association was determined to have been \$127,026. This amount was not collectible due to the fact that the Association was prohibited from paying this amount. The amount was to have been written off by the Company at the end of 2000; however, the Company was unable to separate the lines of business written with the Association from the American States accounting system. The inclusion of these receivables as assets was not in compliance with RCW 48.12.010(10) which allowed as assets only those recoverables from underwriting associations that were collectible.

The Company, through the intercompany pooling agreement, failed to reconcile its accounts receivable for agents' balances in connection with transactions with various insurance and reinsurance syndicates and the treaties therewith. The Company's portion of the unreconciled amounts totaled \$8,978. The Company acknowledged that it was unable to provide the reconciliations and that such reconciliations would be preformed in the future. Due to the lack of such reconciliations, the Company was unable to determine if the amounts receivable were not more than ninety days past due. The inclusion of these receivables as assets was not in compliance with RCW 48.12.010(5) which allowed as assets in the course of collection only those premiums that were not more than ninety days past due.

The Company, through the intercompany pooling agreement, had agents' balances that had been due for over ten years but had not been written off. The Company's portion of these agents' balances in excess of ninety days totaled \$2,669. The inclusion of these receivables as assets was not in compliance with RCW 48.12.010(5) which allowed as assets in the course of collection only those premiums that were not more than ninety days past due.

Testing of the 2000 year-end amounts for agents' balances or uncollected premiums was not possible due to the fact that the Company's records for such accounts for these assets were routinely overwritten on a monthly basis. This was not in compliance with RCW 48.05.280

which required that the Company keep full and adequate accounts and records of its assets, obligations, transactions, and affairs. Since the data for agents' balances was not available and could not be tested as of December 31, 2000, the examination team traced and tested agents' balances from a December 31, 2001 master file provided by the Company and selected records were sampled and traced back to year end 2000 data. Agents' balances totaling \$138,673 have been nonadmitted on the balance sheet of this report.

The Company is instructed to comply with RCW 48.12.010(5) and (10) in determining the admissibility of agents' balances or uncollected premiums. The Company is also instructed to comply with RCW 48.05.280 which requires that the Company keep full and adequate accounts and records of its assets. The Company is instructed to comply with RCW 48.05.250(1) which requires that the Company file a true statement of its financial condition.

9. Safekeeping of Securities

As of December 31, 2000, the Company had a September 22, 1995 custodial agreement with BankAmerica State Trust Company, as authorized agent for Seattle-First National Bank. A September 22, 1995 letter from The Bank of New York indicated that a corporate custody agreement dated July 13, 1987 between the SAFECO companies and BankAmerica Corporation was being assigned to BNY Western Trust Company. The 1995 letter was incorrect in that it should have referred to the 1995 agreement rather the 1987 agreement. During the examination, the Company entered into a new custody agreement with BNY Western Trust Company, a subsidiary of The Bank of New York Company, Inc., dated July 23, 2001. The 2001 agreement was amended by the Company and the bank on August 23, 2001 to comply with the NAIC guidelines.

The Company is instructed to use due care and diligence in the tracking and oversight of custodial arrangements entered into to comply with RCW 48.05.280 which requires the Company to keep full and adequate accounts and records of its affairs and to maintain compliance with NAIC guidelines.

10. Inadequate Records of Agents' Balances

The Company's documentation for agents' balances as of December 31, 2000 had been overwritten by the Company by the time the information was requested. Support for year-end balances should be retained by the Company at a minimum until it has been examined.

The Company is instructed to comply with RCW 48.05.280 which requires the Company to keep full and adequate accounts and records of its assets, obligations, transactions and affairs.

11. Incomplete and Incorrect Finance Committee Minutes

Quarterly minutes of the Company's Finance Committee meetings covering the period from January 1, 1996 through December 31, 2000 were incomplete as the Company was unable to locate the August 5, 1996 Finance Committee minutes.

During 1998, the Company acquired two bonds from affiliates American States Insurance Company and American Economy Insurance Company and, during 1999, the Company transferred two common stocks to affiliates American Economy Insurance Company and General Insurance Company of America in connection with settlements under pooling arrangements. The transactions were not reported in the Company's Finance Committee Minutes. The Company indicated that inter-company transactions and transactions with affiliates are not recorded in the Finance Committee Minutes.

The Company is instructed to comply with RCW 48.13.340 which provides that no investment, sale or exchange shall be made by any domestic company unless authorized or approved by its Board of Directors or by a committee charged by the Board of Directors or the Bylaws with the duty of making such investment, sale or exchange and with RCW 48.05.280 which provides that every insurer shall keep full and adequate accounts and records of its assets, obligations, transactions and affairs.

COMMENTS AND RECOMMENDATIONS

The examiners developed the following comments and recommendation:

1. Investment Guidelines

The investment guidelines adopted by the Company on May 1, 2000 covered both the SAFECO Group of life companies and the SAFECO Group of property and casualty companies on a consolidated basis. Both the 2000 and 2001 investment guidelines had paragraphs that were incorrectly numbered or incomplete.

The Company adopted new investment guidelines effective January 1, 2002 that were correctly numbered; however, these guidelines were also on a consolidated basis for the life and property/casualty companies in the SAFECO Group. Before the January 1, 2002 investment guidelines were adopted, it was suggested to the Company that they be prepared on an individual company basis rather than on a consolidated basis. The consolidated guidelines adopted in 2002 currently cover the SAFECO Group of companies that are domiciled in a number of different states and have different limitations for various assets. An example of the investment limitations on an individual company basis are contained in RCW 48.13.180 and RCW 48.13.273.

It is recommended the Company adopt individual investment guidelines that cover the investment requirements in the Washington Insurance Code.

HISTORY

First National Insurance Company of America was incorporated October 28, 1928 under the laws of the state of Washington and began business on November 1, 1928. The Company's \$5,000,000 in paid up capital consisted of 20,000 common shares at \$250 par value each. All of the authorized shares were outstanding.

CAPITAL AND SURPLUS

As of December 31, 2000, the authorized capital stock of the Company consisted of 20,000 shares of common stock with a par value of \$250 per share, of which 20,000 shares were issued and outstanding. The following schedule summarizes the changes in the Company's capital structure since the date of the last examination:

<u>Date</u>	Authorized and Outstanding <u>Shares</u>	Par <u>Value</u>	Capital Paid-Up	Paid In and Contributed <u>Surplus</u>
December 31, 1995	20,000	\$250	\$5,000,000	\$581,836
December 31, 2000	20,000	250	5,000,000	581,836

Dividends Paid to Shareholder

Dividends paid by the Company during the five-year period covered by this examination to SAFECO Corporation, the parent company, were as follows:

<u>Year</u>	<u>Dividends Paid To Shareholder</u>
1996	\$ 4,000,000
1997	29,500,000
1998	9,000,000
1999	8,000,000
2000	10,000,000

Dividends Paid to Policyholders

Dividends paid by the Company during the five-year period covered by this examination to policyholders were as follows:

<u>Year</u>	<u>Dividends Paid To Policyholders</u>
1996	\$648,837
1997	690,773
1998	285,018
1999	212,623
2000	189,084

MANAGEMENT AND CONTROL

Shareholder

The Company's outstanding shares were 100% owned by SAFECO Corporation, an insurance holding company incorporated under the laws of the state of Washington.

SAFECO Corporation, directly or indirectly, owned the stocks of operating subsidiaries engaged in various phases of the insurance business and other financially related lines of business.

Board of Directors

The affairs of the Company were managed and its corporate powers were exercised by the authority of a nine member Board of Directors. The membership of the Board as of December 31, 2000, together with the city and state of residence and principal business or professional affiliation of each director, were as follows:

<u>Name/Address</u>	<u>Position(s)/Principal Affiliation(s)</u>
Donald Shelton Chapman Woodinville, Washington	Senior Vice President, Chief Operating Officer SAFECO Insurance Company of America (Commercial Insurance)
Boh Andrew Dickey Woodinville, Washington	President and Chief Operating Officer SAFECO Corporation
Roger Harry Eigsti Seattle, Washington	Chairman and Chief Executive Officer SAFECO Corporation

Board of Directors, Cont'd

<u>Name/Address</u>	<u>Position(s)/Principal Affiliation(s)</u>
Dale Ellis Lauer Woodinville, Washington	Senior Vice President SAFECO Insurance Company of America (American States Business Insurance)
William Thomas Lebo Lake Forest Park, Washington	Executive Vice President SAFECO Insurance Company of America
Rodney Allen Pierson Redmond, Washington	Senior Vice President, Chief Financial Officer, Secretary SAFECO Corporation
James Walter Ruddy Mercer Island, Washington	Senior Vice President, General Counsel SAFECO Corporation
Ronald Lee Spaulding Mill Creek, Washington	Treasurer and Chief Investment Officer SAFECO Corporation
Randall Howard Talbot Medina, Washington	President SAFECO Life Insurance Company

During January 2001, Roger Harry Eigsti and Boh Andrew Dickey resigned from the Board of Directors and Roger Floyd Harbin and Michael Sean McGavick were elected to the Board of Directors.

Officers

Officers of the Company as of December 31, 2000 were:

<u>Name</u>	<u>Position</u>
Boh Andrew Dickey	President
Steven Conrad Bauer	Treasurer
Rodney Allen Pierson	Secretary and Vice President
Richard Robert Berls	Vice President
Donald Shelton Chapman	Vice President
Peter Edward Dunn	Vice President
Dale Ellis Lauer	Vice President
William Thomas Lebo	Vice President
James Arthur Schmidt	Vice President
Robert Clark Taylor	Vice President
William Edward Thomas	Vice President

Effective January 30, 2001, Boh Andrew Dickey resigned as president of the Company and Michael Sean McGavick was appointed as president.

Finance Committee

The Company's Finance Committee consisted of the following members as of December 31, 2000:

Roger Harry Eigsti – Chairman
Boh Andrew Dickey
Rodney Allen Pierson
Ronald Lee Spaulding

During January 2001, Roger Harry Eigsti and Boh Andrew Dickey resigned from the Finance Committee and Michael Sean McGavick was appointed as a member of the Finance Committee. The number of members on the Finance Committee was reduced from four to three members.

CONFLICT OF INTEREST

The Company had an operating procedure for disclosing conflicts of interest to the Board of Directors. Statements are circulated among the directors, officers and key employees every year as set forth in the Company's Policy of Ethical Standards, Conflicts of Interest and Compliance with Laws. The Company had a procedure for obtaining disclosure statements from new appointees during the interim.

A review of the completed statements disclosed that the directors, officers and key employees had no conflicts of interest as of December 31, 2000.

AFFILIATED COMPANIES

The Company was a wholly-owned subsidiary of SAFECO Corporation. SAFECO Corporation was the ultimate controlling person. As a member of an Insurance Holding Company System, registration statements were required to be filed in accordance with RCW 48.31B.025 and WAC 284-18-300. SAFECO Corporation filed the registration statements for each year under examination on behalf of the Company, its parent company and its affiliated companies.

The following chart was taken from the SAFECO Corporation Organizational and Entity Chart:

SAFECO Corporation	100% Publicly Owned
SAFECO Financial Products, Inc.	100% SAFECO Corporation
SAFECO Insurance Company of Oregon	100% SAFECO Corporation

AFFILIATED COMPANIES, Cont'd

General America Corporation	100% SAFECO Corporation
Talbot Financial Corporation	100% General America Corporation
F. B. Beattie & Co., Inc.	100% General America Corporation
SAFECO Investment Services, Inc.	100% General America Corporation
SAFECO Select Insurance Services, Inc.	100% General America Corporation
R. F. Bailey Holding Limited	100% General America Corporation
General America Corporation of Texas – Attorney in Fact for:	100% General America Corporation
SAFECO Lloyds Insurance Company	Attorney in Fact
American States Lloyds Insurance Company	Attorney in Fact
First National Insurance Company of America	100% SAFECO Corporation
SAFECO Insurance Company of America	100% SAFECO Corporation
SAFECO Management Corporation	100% SAFECO Insurance Company of America
SAFECO Surplus Lines Insurance Company	100% SAFECO Insurance Company of America
Emerald City Insurance Agency, Inc.	100% SAFECO Insurance Company of America
SAFECO National Insurance Company (Missouri)	100% SAFECO Corporation
General Insurance Company of America	100% SAFECO Corporation
SAFECO Insurance Company of Pennsylvania	100% General Insurance Company of America
SAFECO Insurance Company of Illinois	100% SAFECO Corporation
Insurance Company of Illinois	100% SAFECO Insurance Company of Illinois
American States Insurance Company (Indiana)	100% SAFECO Corporation
American Economy Insurance Company (Indiana)	100% SAFECO Corporation
American States Insurance Company of Texas	100% American Economy Insurance Company
American States Preferred Insurance Company (Indiana)	100% SAFECO Corporation
SAFECO Credit Company Inc.	100% SAFECO Corporation
SAFECO Properties, Inc.	100% SAFECO Corporation
Winmar Company, Inc.	100% SAFECO Properties, Inc.
SAFECARE Company, Inc.	100% SAFECO Properties, Inc.
SAFECO Life Insurance Company	100% SAFECO Corporation
SAFECO National Life Insurance Company	100% SAFECO Life Insurance Company
American States Life Insurance Company	100% SAFECO Life Insurance Company
First SAFECO National Life Insurance Company of New York	100% SAFECO Life Insurance Company
D. W. Van Dyke & Co., Inc.	100% SAFECO Life Insurance Company
Medical Risk Managers, Inc.	15% SAFECO Life Insurance Company 85% D. W. Van Dyke & Co., Inc.
SAFECO Asset Management Company	100% SAFECO Corporation
Barrier Ridge LLC	100% SAFECO Corporation
SAFECO Services Corporation	100% SAFECO Corporation
SAFECO Securities, Inc.	100% SAFECO Corporation
SAFECO eCommerce, Inc.	100% SAFECO Corporation
SAFECO Trust Company	100% SAFECO Corporation
SAFECO UK Limited	100% SAFECO Corporation
SAFECO Administrative Services, Inc.	100% SAFECO Corporation
SAFECO Assigned Benefits Service Company	100% SAFECO Corporation

The Company failed to include in its organizational chart numerous insurance agencies which were owned either directly by SAFECO Corporation or by an affiliate. The NAIC Annual Statement Instructions indicate for Schedule Y, Part 1, that a chart or listing presenting the identities of and interrelationships between the parent, all affiliated insurers and other affiliates should be attached to the Annual Statement. RCW 48.01.050 defined an insurer as every person engaged in the business of making contracts of insurance. The Company did not list the following insurance agencies in Schedule Y, Part 1 (shown below with the parent company relationship):

- SAFECO Insurance Company of America
 - Emerald City Insurance Agency, Inc.
 - Puget Structured Benefit Agency, Inc.
- SAFECO Select Insurance Services, Inc.
 - Pilot Insurance Services, Inc.
- Talbot Agency, Inc.
 - Talbot Financial Services, Inc.
 - Talbot Insurance Agency of Alabama, Inc.
 - Talbot Insurance Agency of Texas, Inc.
 - Talbot Agency of Texas, Inc.
- General America Corporation
 - F. B. Beattie & Company, Inc.
 - F. B. Beattie Insurance Services, Inc.
- R. F. Bailey Holding Limited
 - R. F. Bailey (Underwriting Services) Limited
- SAFECO Life Insurance Company
 - D. W. Van Dyke & Co., Inc.
 - Medical Risk Managers, Inc.

CORPORATE RECORDS

Minutes

The minutes of the Shareholder, Board of Directors and Finance Committee meetings for the period covered under examination were reviewed. Investments were reviewed by the Finance Committee and the Finance Committee minutes were ratified by the Board of Directors; however, the minutes for one quarterly Finance Committee meeting were not located by the Company during the examination.

Contracts/Service Agreements

The following agreements were in force as of December 31, 2000:

1. Intercompany Tax Allocation Agreement dated August 1, 1990. A consolidated return was filed by SAFECO Corporation with the companies included in Schedule Y of the Annual Statement in which there was an 80% or more ownership, except for American States Life Insurance Company. The allocation was based upon separate return calculations with current credit for net losses as such losses offset taxable income of other members of the consolidated group. Intercompany tax balances were settled quarterly.
2. A Short-Term Borrowing Agreement dated October 27, 1997 between the Company, as lender, and SAFECO Credit Company, Inc., as borrower.
3. The Company and twenty other affiliated companies in the SAFECO Group were named in an Intercompany Short-Term Borrowing Agreement effective November 15, 2000.
4. Expense Sharing Agreement dated November 3, 1983. The Agreement covers payroll, use of real property, and miscellaneous expenses for sixteen stock companies within the SAFECO Group, which includes the six Washington domestic insurance companies. All of the companies are 100%-owned direct or indirect subsidiaries of SAFECO Corporation, the ultimate controlling person in the SAFECO holding company system.

Intercompany Agreements should be used to document recurring transaction patterns between or among the SAFECO Group member companies. RCW 48.31B.030(1)(a)(iv), requires that records are to "...clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees..." An extensive volume of investment transactions were conducted between the SAFECO insurance companies and SAFECO Asset Management Company, but there was no intercompany agreement specifying the parties' rights, duties and compensation. All such agreements are required to be filed and approved by OIC. See item 4 under the "INSTRUCTIONS" portion of this Examination Report.

FIDELITY BONDS AND OTHER INSURANCE

The Company's fidelity insurance was extended to affiliated companies through a Financial Institution Bond issued to SAFECO Corporation which provided coverage up to \$3,000,000 aggregate with no deductible. The companies carry excess insurance which provided an additional amount of coverage in layers through several carriers. The minimum amount of fidelity insurance coverage recommended by the NAIC for a company of this size is \$400,000 to \$450,000. This minimum amount was met with the Financial Institution Bond and the excess insurance.

The Company was a named insured on various insurance policies issued to SAFECO Corporation that provided protection against certain property and liability losses. Policies providing property coverage for buildings and contents, comprehensive commercial general liability and automobile bodily injury and property damage coverage were in effect during the period covered by this examination.

The Company was a named insured on a Directors and Officers Liability Policy with an authorized insurance carrier. Errors and Omissions coverage was also provided under this policy.

OFFICERS', EMPLOYEES', AND AGENTS' WELFARE AND PENSION PLANS

The employees of the SAFECO Group of property/casualty and life companies were treated as employees of SAFECO Insurance Company of America. The salaries and benefits paid or accrued to these employees were allocated and prorated to the various companies in the Group based on the intercompany pooling agreement and other intercompany arrangements.

The SAFECO Group had the following benefit plans available to officers, employees and their dependents: Group Life Insurance, Accidental Death and Dismemberment, Long-term Disability, Medical and Dental. The SAFECO Group contributes to the Life, Medical and Dental plans.

The SAFECO Group had the following retirement and profit sharing plans:

1. **Cash Balance Plan** – A defined contribution plan established during 1989. The plan provided an annual credit to each employee's account, regardless of profitability of the SAFECO Group. The amount was 3% of eligible compensation paid each year to the participants. The participant's balances were credited with interest at a rate of 5%.
2. **Profit Sharing Bonus** – A cash bonus was paid to the salaried employees who had completed one calendar year of service. Each year 10% of the "adjusted underwriting profit" of the SAFECO Group earned during the previous year was allocated to the profit sharing bonus plan. A cash bonus was then paid to the eligible employees based on a percentage of the previous year's base salary. An employee with three or more calendar years of service could receive a maximum cash bonus of 10% of his or her previous year's salary.
3. **Profit Sharing Retirement Plan** – A defined contribution plan where contributions are based on the SAFECO Group's profit, 5% of net profit, before taxes and stockholder's dividends and after subtracting an amount credited to the Cash Balance Plan. The maximum contribution to the trust shall not exceed 12% of eligible compensation paid each year to the participants.

4. **Employees' Savings Plan** – A defined contribution plan was established during 1967. The plan was available to an employee after 12 calendar months of service. An employee could save up to 6% of basic salary. The companies contributed an amount equal to two-thirds of the employee's deduction.

SAFECO Corporation had a stock option plan for executives and key employees. The stock was issued in SAFECO Corporation. In addition, two non-qualified benefit plans were established during 1989 for the companies' contributions to the Profit Sharing Retirement Plan in excess of the amounts allowed by the Internal Revenue Service.

The Company had a separate plan available for its independent agents and agencies. The plan was 100% funded by the agents and agencies and included Group Life, Accidental Death and Dismemberment and Long-Term Disability.

TERRITORY AND PLAN OF OPERATION

The Company was authorized to transact multiple lines business in all states of the United States, except Maine and New Hampshire, and was also authorized to transact multiple lines business in the District of Columbia and the Dominion of Canada.

The property and casualty insurance companies in the SAFECO Insurance Group are under common management. They share services in the areas of company operation, including investment, claim handling, state filings, legal, data processing, personnel, statistical and accounting.

The property and casualty companies within the SAFECO Insurance Group operate within the independent agency system. They provide both personal and commercial property and casualty markets and are divided into two enterprise units for operational ease; SAFECO Business Insurance and SAFECO Personal Insurance. The business enterprise has five regional offices (Redmond, WA, Fountain Valley, CA, Richardson, TX, Indianapolis, IN, and Atlanta, GA) while the personal enterprise has two regional offices (Redmond, WA and Atlanta, GA). Appropriate claims offices are maintained throughout the United States to provide effective and efficient service to claimants.

GROWTH OF COMPANY

The growth of the Company for the past five years is reflected in the following exhibit (000's omitted) prepared from the filed annual statements:

<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Capital</u>	<u>Surplus</u>	<u>Premiums Earned</u>
2000	\$199,290	\$134,478	\$5,000	\$59,812	\$91,029
1999	203,088	130,271	5,000	67,817	87,538
1998	205,821	131,832	5,000	68,989	84,166
1997	199,492	128,562	5,000	65,930	96,304
1996	210,331	125,081	5,000	80,250	91,015

LOSS EXPERIENCE

The reserves carried by the combined property and casualty companies of the SAFECO Group for these liabilities were \$3,482,472,780 and \$786,665,886, respectively, as of December 31, 2000.

The reserves for the combined companies were reviewed by the casualty actuarial staff employed by the OIC. Company personnel provided loss and loss adjustment expense development data for these lines of business as of June 30, 2002 (in other words, the data included eighteen months of development subsequent to the examination period). Based on their analysis of data through June 30, 2002, the OIC's actuarial staff concluded that the companies booked reserves, particularly for the workers' compensation and general liability lines of business, were deficient as of December 31, 2000. Since December 31, 2000, the companies have taken significant steps to strengthen their loss and loss adjustment expense reserves for 2000 and prior years. These steps were reflected, in part, in the one year loss development of \$339,274,000 for all lines of business shown on Page 23 of the combined companies' Annual Statement for 2001.

The OIC's actuarial staff made the following examination adjustments to the reserves as of December 31, 2000, on a combined-companies basis:

	<u>Booked Reserve</u>	<u>Examination Adjustment</u>	<u>Restated Reserve</u>
Losses	\$3,482,472,780	\$357,829,000	\$3,840,301,780
Loss adjustment expenses	786,665,886	93,742,000	880,407,886

Under the SAFECO intercompany pooling agreement, the Company's liability was 2% of the total. Therefore, the examination adjustments to the Company's reserves as of December 31, 2000, were:

	<u>Booked</u> <u>Reserve</u>	<u>Examination</u> <u>Adjustment</u>	<u>Restated</u> <u>Reserve</u>
Losses	\$ 69,649,457	\$ 7,156,580	\$ 76,806,037
Loss adjustment expenses	15,733,318	1,874,840	17,608,158

See "INSTRUCTIONS" No. 2 – Loss and Loss Adjustment Expense Reserves in which the Company is instructed to make provision for the examination adjustments to its loss and loss adjustment expense reserves which will place the Company in compliance with RCW 48.12.030(2). This section of the Washington Insurance Code provides that the Company estimate its provision to pay its unpaid losses and claims incurred on or prior to the date of the annual statement together with the expense of adjustment or settlement thereof.

REINSURANCE

Intercompany Pooling Agreement

The Company had entered into an intercompany reinsurance agreement whereby SAFECO Insurance Company of America, an affiliate, assumed 100% of the direct business written by the Company and assumed 100% of the direct business written and assumed by 13 other affiliated companies. The direct business written by SAFECO Insurance Company of America and the business assumed from the 14 affiliated companies was pooled. The parent company arranged for excess and catastrophe reinsurance with nonaffiliated companies, as needed. The pooled business was retroceded to the following companies in the percentages stated below:

SAFECO Insurance Company of America	33%
General Insurance Company of America	23%
First National Insurance Company of America	2%
SAFECO National Insurance Company	2%
SAFECO Insurance Company of Illinois	5%
American States Insurance Company	19%
American States Preferred Insurance Company	2%
American Economy Insurance Company	14%
SAFECO Lloyds Insurance Company	0%
SAFECO Insurance Company of Pennsylvania	0%
SAFECO Insurance Company of Oregon	0%
SAFECO Surplus Lines Insurance Company	0%
Insurance Company of Illinois	0%
American States Insurance Company of Texas	0%
American States Lloyds Insurance Company	0%
Total	<u>100%</u>

As of December 31, 2000, the Company had \$409,887,000 in aggregate unsecured amounts recoverable from SAFECO Insurance Company of America.

ACCOUNTS AND RECORDS

The external audit firm of Ernst and Young LLP was retained by the Company to audit the Company's statutory financial statements for the years under examination. Reports for 1999 and 2000 were provided as well as the work papers for 2000. As part of the audit work papers, the internal control structure noted deficiencies in the timely preparation of bank reconciliations and the clearance of items listed on the reconciliations.

The Internal Audit Department of the parent company, SAFECO Corporation, performed audits of the Company and provided recommendations to management on internal controls and operational procedures.

The Examiners independently tested internal controls and the following significant weaknesses were found:

1. General Ledger Control (GLC) Accounts – Reconciliations between the general ledger and subsidiary records for a number of accounts, including cash, were centrally maintained for most SAFECO companies by one department, GLC. GLC identified differences between the general and subsidiary accounts and referred the specific items (variances) to the originating SAFECO department for investigation and potential correction. During the five-year period under examination, there were numerous variances that were not cleared but were continuously outstanding. This resulted from a lack of consistent accounting discipline and control and appropriate management guidance to clear variances on a timely basis. In mid-2002, the SAFECO Group of companies began the implementation of a new, stronger control process to ensure account accuracy and to control timely reconciliation of accounts.
2. Cash – A number of instances were noted in which the cash administrative database contained erroneous or incomplete information, including Company bank accounts which did not appear on the General Ledger or in the database. This condition resulted from the opening or amendment of bank accounts by parties other than those in the central bank administration department. Company employees should be made aware that only the bank administration department can open or change bank accounts.

During the examination, the Company engaged an external firm to guide and oversee the resolution of the many cash and other account reconciliations that had been in process for years and to put in place new procedures and controls.

Electronic Data Processing System

The management of the Company had sufficient knowledge of electronic data processing issues and provided direction and oversight through its Business Application Groups. Systems development, acquisition and maintenance controls were evaluated to gain assurance that programs and systems were designed, tested, approved and implemented using appropriate controls. The internal controls in place provided for the proper separation of duties.

Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed and the controls exercised to maintain data security. Adequate procedures and controls were in place for mainframe and network operations.

CONTINGENT LIABILITIES AND LEASES

As of December 31, 2000, the Company had purchased structured settlement annuities from SAFECO Life Insurance Company under which the claimant is payee but for which the Company is contingently liable. The loss reserves eliminated by the annuities totaled \$2,156,257.

SUBSEQUENT EVENTS

1. On December 20, 2002, the OIC issued Order No. 98 granting approval of a special consent investment. The Order, effective December 31, 2000, gave the Company special consent to acquire and hold foreign securities in excess of the limitations contained in RCW 48.13.030 and RCW 48.13.180. The Order provided that the investments authorized by this Order may be credited to the Company's minimum capital or surplus or required reserves pursuant to RCW 48.13.250. The investments authorized by the Order shall be eligible for classification as admitted assets of the Company. The Order indicated that the Company desired to be in compliance with the OIC's interpretation of the Code, and so intends to divest itself of these foreign securities no later than November 15, 2004, unless before that time the investments attain the standard of eligibility.
2. The NAIC adopted Statements of Statutory Accounting Principles (Codification) effective January 1, 2001. The effect of Codification resulted in a \$2,241,387 increase in the Company's 2001 Statutory Surplus.
3. On November 8, 2001, the Company's Bylaws were amended to revise the Regular Meeting verbiage. The reference to a specific meeting date each quarter was removed and replaced with wording that requires a quarterly meeting on a date and place to be specified. This amendment was made to allow the Board of Directors more flexibility and places the

Company's Bylaws in compliance with the other insurance companies within the SAFECO Group.

4. The Company paid its shareholder, SAFECO Corporation, \$4,100,000 in dividends in 2001 and \$5,000,000 in dividends in 2002.
5. The reserves carried by the combined property and casualty companies of the SAFECO Group for the loss reserves and for the loss adjustment expenses were \$3,482,472,780 and \$786,665,886, respectively, as of December 31, 2000. During the third quarter of 2001, the SAFECO Group completed a review of its loss reserve adequacy. As a result of this review, the SAFECO Group increased reserves by \$240,000,000 which relates to recent developments in prior year claims as follows: \$80,000,000 for workers' compensation, \$90,000,000 for construction defect, and \$70,000,000 for other coverages including asbestos and environmental. The review of loss reserve adequacy concluded that personal lines reserves were adequate. The increase in reserves for these particular lines was included in the end of the year loss development for all lines which totaled \$339,274,000 as shown on Page 23 of the combined companies' Annual Statement for 2001.

In the case of workers' compensation, the \$80,000,000 increase was due to unexpected development of prior year claims and continued increases in medical costs. This includes the impact of administrative rulings that have been more favorable to plaintiffs' claims for compensation, particularly in the states of California and Florida. The estimation of liabilities related to construction defects and asbestos and environmental claims noted continued emergence of adverse loss experience for construction defect and asbestos and environmental claims due to newly emerging trends in the disposition of such cases. As a result of the review, the SAFECO Group concluded that ultimate losses for these lines will be higher in the range of possible outcomes than previously estimated.

The \$90,000,000 increase in construction defect reserves was due to continued adverse development on prior year claims and the expansion of the number of claims in states outside California. Recent state courts' rulings have expanded the number of claims beyond those contemplated by the SAFECO Group's original estimate.

The \$70,000,000 increase in reserves for other lines, including asbestos and environmental claims, relates to the anticipated increase in asbestos claims relating primarily to the discontinued reinsurance operations acquired in the American States purchase.

During the first quarter of 2002, SAFECO Group also added \$10,000,000 to loss reserves for workers' compensation policies from prior years.

Under the SAFECO intercompany pooling agreement, the Company's liability was 2% of the total.

FINANCIAL STATEMENTS

The following statements, with the exception of the Five Year Reconciliation of Capital and Surplus as stated by the Company, reflect the financial condition of the Company as of December 31, 2000, as determined by this examination:

Balance Sheet
As of December 31, 2000

Statement of Income
Year Ended December 31, 2000

Capital and Surplus Account
As of December 31, 2000

Reconciliation of Capital and Surplus Account
For the Five Year Examination Period (Per Company)

Comparative Analysis of Changes of Surplus
As of December 31, 2000

FIRST NATIONAL INSURANCE COMPANY OF AMERICA
Balance Sheet
As of December 31, 2000

	<u>BALANCE PER COMPANY</u>	<u>NOTES</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<u>ASSETS</u>				
Bonds	\$ 116,528,624	1	\$ -	\$ 116,528,624
Stocks:				
Preferred stocks	183,906	2		183,906
Common stocks	35,476,727			35,476,727
Real estate:				
Properties occupied by the company	3,850,082			3,850,082
Cash and short-term investments	20,287,567	3	(116,702)	20,170,865
Receivable for securities	5,096		-	5,096
Subtotals, cash and invested assets	\$ 176,332,002		\$ (116,702)	\$ 176,215,300
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	3,464,164	4	(138,673)	3,325,491
Premiums, agents' balances and installments booked but deferred and not yet due	15,195,653			15,195,653
Accrued retrospective premiums	91,258			91,258
Guaranty funds receivable or on deposit	119,740			119,740
Interest, dividends and real estate income due and accrued	1,948,030	1		1,948,030
Receivable from parent, subsidiaries and affiliates	2,139,163		-	2,139,163
Total Assets	\$ 199,290,010		\$ (255,375)	\$ 199,034,635

FIRST NATIONAL INSURANCE COMPANY OF AMERICA

Balance Sheet

As of December 31, 2000

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>NOTES</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
<u>LIABILITIES</u>				
Losses	\$ 69,649,457	5	\$ 7,156,580	\$ 76,806,037
Loss adjustment expenses	15,733,318	5	1,874,840	17,608,158
Contingent commissions and other charges	1,831,634			1,831,634
Other expenses (excluding taxes, licenses and fees)	2,329,152			2,329,152
Federal and Foreign income taxes (excluding deferred taxes)	885,536			885,536
Unearned premiums	35,412,234			35,412,234
Dividends declared and unpaid: Policyholders	508,365			508,365
Amounts withheld or retained by company for others	1,342,465			1,342,465
Net adjustments in assets and liabilities due to foreign exchange rates	908,582			908,582
Payable to parent, subsidiaries and affiliates	-			-
Payable for securities	2,645,411			2,645,411
Aggregate write-ins for liabilities	<u>3,232,201</u>		<u>-</u>	<u>3,232,201</u>
Total Liabilities	<u>\$ 134,478,355</u>		<u>\$ 9,031,420</u>	<u>\$ 143,509,775</u>
<u>SURPLUS AND OTHER FUNDS</u>				
Common capital stock	\$ 5,000,000		\$ -	\$ 5,000,000
Gross paid in and contributed surplus	581,836			581,836
Unassigned funds (surplus)	<u>59,229,819</u>		<u>(9,286,795)</u>	<u>49,943,024</u>
Surplus as regards policyholders	<u>\$ 64,811,655</u>		<u>\$ (9,286,795)</u>	<u>\$ 55,524,860</u>
Total Liabilities, Surplus and Other Funds	<u>\$ 199,290,010</u>		<u>\$ (255,375)</u>	<u>\$ 199,034,635</u>

FIRST NATIONAL INSURANCE COMPANY OF AMERICA
Statement of Income
For the Year Ended December 31, 2000

	<u>BALANCE PER COMPANY</u>	<u>NOTES</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
<u>UNDERWRITING INCOME</u>				
Premiums earned	\$ 91,028,515		\$ -	\$ 91,028,515
DEDUCTIONS				
Losses incurred	\$ 64,305,171	5	\$ 7,156,580	\$ 71,461,751
Loss expenses incurred	11,093,992	5	1,874,840	12,968,832
Other underwriting expenses incurred	26,341,391		-	26,341,391
Total underwriting deductions	<u>\$ 101,740,554</u>		<u>\$ 9,031,420</u>	<u>\$ 110,771,974</u>
Net underwriting gain or (loss)	<u>\$ (10,712,039)</u>		<u>\$ 9,031,420</u>	<u>\$ (19,743,459)</u>
<u>INVESTMENT INCOME</u>				
Net investment income earned	\$ 9,793,196		\$ -	\$ 9,793,196
Net realized capital gains or (losses)	3,903,159		-	3,903,159
Net investment gain or (loss)	<u>\$ 13,696,355</u>		<u>\$ -</u>	<u>\$ 13,696,355</u>
<u>OTHER INCOME</u>				
Net gain or (loss) from agents' or premium balances charged off	\$ (61,938)		\$ -	\$ (61,938)
Finance and service charges not included in premiums	374,781		-	374,781
Total other income	<u>\$ 312,843</u>		<u>\$ -</u>	<u>\$ 312,843</u>
Net income before dividends to policyholders and before federal and foreign income taxes	\$ 3,297,159		\$ 9,031,420	\$ (5,734,261)
Dividends to policyholders	<u>189,084</u>		<u>-</u>	<u>189,084</u>
Net income after dividends to policyholders but before federal and foreign income taxes	\$ 3,108,075		\$ 9,031,420	\$ (5,923,345)
Federal and foreign income taxes incurred	<u>(696,679)</u>		<u>-</u>	<u>(696,679)</u>
Net Income	<u>\$ 3,804,754</u>		<u>\$ 9,031,420</u>	<u>\$ (5,226,666)</u>

FIRST NATIONAL INSURANCE COMPANY OF AMERICA
Capital and Surplus Account
As of December 31, 2000

	<u>BALANCE PER COMPANY</u>	<u>NOTES</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Surplus as Regards Policyholders, December 31 Prior Year	\$ 72,817,115		\$ -	\$ 72,817,115
<u>GAINS AND (LOSSES) IN SURPLUS</u>				
Net income	\$ 3,804,754	5	\$ (9,031,420)	\$ (5,226,666)
Net unrealized capital gains or (losses)	(1,864,752)	3	(116,702)	(1,981,454)
Change in non-admitted assets	(5,186)	4	(138,673)	(143,859)
Change in foreign exchange adjustment	59,724			59,724
Dividends to stockholders	<u>(10,000,000)</u>		<u>-</u>	<u>(10,000,000)</u>
Change in surplus as regards policyholders for the year	<u>\$ (8,005,460)</u>		<u>\$ (9,286,795)</u>	<u>\$ (17,292,255)</u>
Surplus as Regards Policyholders, December 31 Current Year	<u>\$ 64,811,655</u>		<u>\$ (9,286,795)</u>	<u>\$ 55,524,860</u>

FIRST NATIONAL INSURANCE COMPANY OF AMERICA
Reconciliation of Capital and Surplus Account
For the Five Year Examination Period
(Per Company)

	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Surplus as Regards Policyholders, December 31 Previous Year	<u>\$ 72,817,115</u>	<u>\$ 73,988,462</u>	<u>\$ 70,930,533</u>	<u>\$ 85,249,574</u>	<u>\$ 74,103,460</u>
GAINS AND (LOSSES) IN SURPLUS:					
Net Income	\$ 3,804,754	\$ 10,385,461	\$ 8,152,040	\$ 10,901,552	\$ 11,709,299
Net unrealized capital gains or (losses)	(1,864,752)	(4,707,953)	4,931,225	4,769,672	3,769,761
Change in non-admitted assets	(5,186)	(393,989)	(126,810)	(48,474)	(223,844)
Change in foreign exchange adjustment	59,724	1,545,134	(410,430)	(285,288)	(172,549)
Change in excess of statutory reserves over statement reserves			156,503	(156,503)	63,447
Dividends to stockholders (cash)	(10,000,000)	(8,000,000)	(9,000,000)	(29,500,000)	(4,000,000)
Extraordinary amounts of taxes for prior years			(1,210,219)		
Aggregate write-ins for gains and losses in surplus	<u>-</u>	<u>-</u>	<u>565,620</u>	<u>-</u>	<u>-</u>
Change in surplus as regards policyholders for the year	<u>\$ (8,005,460)</u>	<u>\$ (1,171,347)</u>	<u>\$ 3,057,929</u>	<u>\$ (14,319,041)</u>	<u>\$ 11,146,114</u>
Surplus as Regards Policyholders, December 31 Current Year	<u>\$ 64,811,655</u>	<u>\$ 72,817,115</u>	<u>\$ 73,988,462</u>	<u>\$ 70,930,533</u>	<u>\$ 85,249,574</u>

FIRST NATIONAL INSURANCE COMPANY OF AMERICA
Comparative Analysis of Changes in Surplus
As of December 31, 2000

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination:

	<u>PER COMPANY</u>	<u>PER EXAMINATION</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>	<u>TOTALS</u>
Capital and Surplus, December 31, 2000 - Per Annual Statement	\$	\$		\$ 64,811,655
<u>ASSETS</u>				
Cash and short-term investments	\$ 20,287,567	\$ 20,170,865	\$ (116,702)	
Premiums and agents' balances in course of collection	3,464,164	3,325,491	(138,673)	
<u>LIABILITIES</u>				
Losses	69,649,457	76,806,037	(7,156,580)	
Loss adjustment expense	15,733,318	17,608,158	<u>(1,874,840)</u>	
Change in surplus				<u>(9,286,795)</u>
Capital and Surplus, December 31, 2000 - Per Examination				<u>\$ 55,524,860</u>


NOTES TO FINANCIAL STATEMENTS


1. As of December 31, 2000, the Company had invested in foreign bonds having an admitted value of \$2,993,524 and \$30,100 in accrued interest. RCW 48.13.180 prohibited the Company's investment in foreign securities. The remedies under the Code did not provide for the non-admission of the foreign securities. See "INSTRUCTIONS" No. 3, Prohibited Investments in Foreign Securities.
2. The Company owned shares of a preferred stock that were not reported in Schedule D, Part 2, Section 1 of the Company's 2000 Annual Statement. The Company indicated that the shares reported on the December 31, 2000 bank confirmation had no market value. See "INSTRUCTIONS" No. 7, Preferred Stock Not Reported in Annual Statement.
3. The bank balance reported by the Royal Trust Company, Toronto, Canada, differed from the Company's 2000 Annual Statement balance. The Company subsequently wrote off the \$116,702 unreconciled difference during 2002. See "INSTRUCTIONS" No. 1, Unreconciled Bank Balance.
4. The Company participated in an intercompany pooling agreement. The Company's portion of the premiums and agents' balances in course of collection included \$127,026 in receivables from the Florida Windstorm Underwriting Association that were uncollectible, \$8,978 in unreconciled agents' balances in connection with transactions with insurance and reinsurance syndicates and treaties therewith, and \$2,669 in agents' balances that had been due for over ten years resulting in a \$138,673 adjustment. See "INSTRUCTIONS" No. 8, Agents' Balances or Uncollected Premiums.
5. The reserves for loss and loss adjustment expenses reported by the SAFECO Group of companies on a combined basis as of December 31, 2000 were increased \$357,829,000 and \$93,742,000, respectively. The Company's portion of the increase in reserves under the intercompany pooling agreement resulted in examination adjustments of \$7,156,580 for losses and \$1,874,840 for loss adjustment expenses. See "INSTRUCTIONS" No. 2, Loss and Loss Adjustment Expense Reserves.

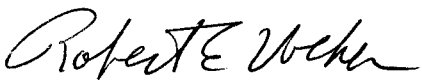
ACKNOWLEDGEMENT

Examiners John J. Gaynard, CPA, CPCU, AFE; Peter M. Mendoza, CFE, CIE; Orlando R. Gabriel, Kehinde Ovbiebo, Constantine Arustamian, CPA; Mike Bosley, CPA; Charles J. Mitchell, CPA; Mitch Coe, CPA; Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner, Eric Slavich, Actuarial Analyst 2, and D. Lee Barclay, FCAS, MAAA, Senior Actuary, from the Washington State Office of Insurance Commissioner, and Richard A. Randour, CFE, CPA, from the State of Delaware participated in the examination and preparation of this report.

Respectfully submitted,


TIMOTEO L. NAVAJA, CFE, CIE
Examiner-in-Charge
Office of Insurance Commissioner
State of Washington


LARRY E. CROSS, CFE, CIE
Insurance Examiner
Representing Delaware
and NAIC Northeastern Zone


ROBERT E. VOLKER, CFE, CIE
Insurance Examiner
Representing Nevada
and NAIC Western Zone

AFFIDAVIT

STATE OF WASHINGTON)
) ss
COUNTY OF KING)

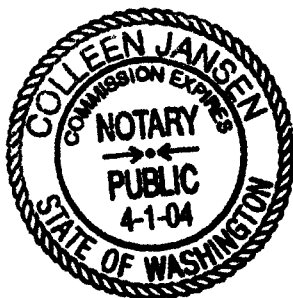
Timoteo L. Navaja, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of First National Insurance Company of America was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Zil. Farangi

TIMOTEO L. NAVAJA, CFE, CIE
Examiner-in-Charge

Subscribed and sworn to before me on this 11th day of September, 2003.



Colleen J. Gasser
Notary Public in and for the State of Michigan

Notary Public in and for the
State of Washington,
residing at Seattle.
My commission expires 7/1/04.